

PAUL B. SNYDER
United States Bankruptcy Judge
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November 8, 2005

MARK L. HATCHER
CLERK U.S. BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA
DEPUTY

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA**

In re:

No. 01-49703 (Lead)

NEIL ROSE,

Debtor.

In re:

No. 01-49934

IMPACT ALLOYS FOUNDRY, INC.,

Debtor.

In re:

No. 01-49935

IMPACT ALLOYS CORPORATION,

Debtor.

In re:

No. 03-52214

NEIL MARTIN ROSE,

Debtor.

KATHRYN A. ELLIS, Trustee

Plaintiff,

v.

Adversary No. 03-4027

MEMORANDUM DECISION

NEIL M. ROSE; JAMES SCOTT ROSE;
BRETT MARTIN ROSE; ALEXANDER C.S.
ROSE; ROSE PERSONAL RESIDENCE
TRUST, Neil M. Rose, Trustee; VALLEY
50th AVE., LLC, a Washington limited liability

NOT FOR PUBLICATION

1 company; and JOHN DOES 1 through 20,
2 Defendants.

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4 Trial in this matter came before the Court on August 31, 2005, on a complaint filed by
5 Kathryn A. Ellis, Chapter 7 Trustee (Chapter 7 Trustee) for the estate of Neil M. Rose (Rose)
6 to recover a transfer under 11 U.S.C. §§ 544, 548, 550 and RCW 19.40.011 et seq. The
7 Chapter 7 Trustee's complaint named several defendants. Only Rose, the Rose Personal
8 Residence Trust (Trust), and Alexander C.S. Rose (Alex Rose), remain as defendants in this
9 action and participated in the August 31, 2005 trial. At the conclusion of the trial, the Court
10 requested post-trial briefing from both parties on the issue of turnover of property of the estate
11 under 11 U.S.C. §§ 541 and 542. The Trust filed a post-trial memorandum on September 19,
12 2005, and the Chapter 7 Trustee filed a reply on September 30, 2005. Based on the
13 evidence, arguments of counsel, and pleadings submitted, the Court makes the following
14 findings of fact and conclusions of law.
15

16 FINDINGS OF FACT

17 Rose sold his business, Canica Foundry Corporation, to Clyde Corporation and Evans
18 Deakin Industries, Ltd. (Petitioning Creditors) in the mid-1990s. A dispute over the terms of
19 the sale subsequently arose, and the Petitioning Creditors filed an action in Clark County
20 Superior Court, State of Washington (State Court) against Rose in October, 1997.

21 On December 29, 1997, Rose executed the Trust, into which he transferred his interest
22 in the residence located at 2110 SE 105th Court, Vancouver, Washington (Property). The
23 Trust had a term of ten years, at the expiration of which, the Property would be distributed to
24 Rose's minor son, Alex Rose. The Property was quitclaimed from Rose personally, to Rose
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1 as Trustee of the Trust on December 29, 1997. The Quit Claim Deed was recorded on
2 January 5, 1998, and re-recorded on February 5, 1998, to correct a notary seal.

3 Trial in the State Court action commenced October 23, 2000. At the conclusion of the
4 trial, the State Court awarded a monetary judgment in favor of the Petitioning Creditors for
5 their attorneys' fees only. The judgment was signed April 12, 2001.

6 Involuntary bankruptcy petitions were filed in accordance with 11 U.S.C. § 303 against
7 Rose, Impact Alloys Foundry, Inc. and Impact Alloys Corporation by the Petitioning Creditors
8 on October 5, 2001 (No. 01-49703), and October 12, 2001 (No. 01-49934 and No. 01-49935),
9 respectively. Orders for relief were entered by this Court in the three cases on November 30,
10 2001, and on January 6, 2003, the Court entered an order directing the joint administration of
11 the cases under Case No. 01-49703. On June 2, 2003, Rose filed a voluntary petition for
12 Chapter 7 relief in bankruptcy court for the District of Arizona under Case No. 03-9444. On
13 November 5, 2003, an order was entered transferring the Arizona case to this district (No. 03-
14 52214), and substantively consolidating the case with No. 01-49703.

15
16 The Chapter 7 Trustee filed an adversary proceeding complaint on February 5, 2003.
17 In the complaint, the Chapter 7 Trustee alleges that the transfer of the Property to the Trust
18 was a fraudulent transfer pursuant to 11 U.S.C. §§ 544, 548 and 550, and RCW 19.40.011 et
19 seq.

20 **CONCLUSIONS OF LAW**

21
22 The Trust first argues that the Chapter 7 Trustee's claims should be dismissed for
23 failure to properly serve Rose, as Trustee of the Trust. The Court agrees with the Chapter 7
24 Trustee that any objections based on insufficiency of process have been waived. Rose
25 appeared in this matter, pro se, on November 5, 2003, and filed a motion to dismiss on

1 February 17, 2004. In accordance with this motion, Rose sought dismissal of all claims, not
2 only those against himself personally, but all defendants. The Court treated the motion to
3 dismiss as an answer on behalf of both Rose personally and as Trustee of the Trust, and set
4 the matter for trial. Numerous other pleadings were subsequently filed by Rose in this
5 proceeding. Insufficiency of process has never been raised as a defense in any of the
6 pleadings filed. The Trust has fully participated in these proceedings and any objection on the
7 basis of insufficient process has been waived. See Fed. R. Civ. P. 12(g) and (h), made
8 applicable to adversary proceedings by Fed. R. Bankr. P. 7012(b) (defense of insufficiency of
9 process is waived if not made by motion nor included in a responsive pleading).
10

11 The Trust next argues that the Court should not consider the Chapter 7 Trustee's claim
12 for turnover pursuant to 11 U.S.C. § 542, because this claim was not sought in the complaint,
13 nor has the Chapter 7 Trustee sought to amend the complaint to add a claim under 11 U.S.C.
14 § 542. The Trust states that the Chapter 7 Trustee first raised the issue of whether the
15 Property constituted property of the estate in the Chapter 7 Trustee's Trial Brief filed August
16 19, 2005.

17 The Trust has not asserted or demonstrated any prejudice in allowing consideration of
18 this claim. The Court gave the Trust an opportunity to respond to this allegation at trial and by
19 allowing the Trust to file a post-trial memorandum addressing the claim. No continuance was
20 requested and this issue was thoroughly briefed and argued by both parties. Fed. R. Civ. P.
21 15(b), made applicable to adversary proceedings by Fed. R. Bankr. P. 7015, allows the Court
22 to amend the pleadings to conform to the evidence, when issues not raised in the pleadings
23 are tried by express or implied consent. See In re Santa Monica Beach Hotel, Ltd., 209 B.R.
24 722, 725 n.8 (9th Cir. BAP 1997). The Court "shall do so freely when the presentation of the
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1 merits of the action will be subverted thereby and the objecting party fails to satisfy the court
2 that the admission of such evidence would prejudice the party in maintaining the party's action
3 or defense upon the merits." Fed. R. Civ. P. 15(b).

4 The Court concludes that the Trust fails to demonstrate any prejudice, and the merits of
5 this action are best served by considering the turnover claim even though not plead in the
6 complaint. The evidence and testimony relevant to this claim were introduced at trial and are
7 factually similar to the evidence necessary to support the other claims raised by the Chapter 7
8 Trustee. The Bankruptcy Code does not impose a statute of limitations on turnover claims
9 arising under 11 U.S.C. § 542, accordingly, the Trust is unable to demonstrate any prejudice
10 on that basis. See In re Mushroom Transp. Co., 382 F.3d 325, 337 (3d Cir. 2004) (no statute
11 of limitations under 11 U.S.C. § 542). The Court will therefore consider this claim in ruling on
12 the merits.

13 NOT FOR PUBLICATION
14 The Chapter 7 Trustee alleges that the Property at issue is property of Rose's
15 bankruptcy estate and therefore subject to turnover under 11 U.S.C. § 542. 11 U.S.C.
16 § 541(a)(1) includes in a debtor's estate, "all legal or equitable interests of the debtor in
17 property as of the commencement of the case."

18 Any interest that a debtor retains in a trust is property of the estate, including the power
19 to amend or revoke a trust, and to recover the trust assets for the benefit of creditors. In re
20 LivingWell, Inc., 45 F.3d 103, 106 (5th Cir. 1995) (citing In re Gifford, 93 B.R. 636, 640 (Bankr.
21 N.D. Ind. 1988)). "Thus, what comes into the bankruptcy estate is not only the property in
22 which debtor has an interest, but also, the powers the debtor can exercise for its own benefit
23 over property, regardless of the title debtor may be acting under." Gifford, 93 B.R. at 640.
24 Additionally, the bankruptcy court is to look to state law in defining the scope and existence of
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1 a property interest under 11 U.S.C. § 541. Under Washington state law, Rose's property
2 interest in the Property is not shielded from the claims of creditors.

3 RCW 19.36.020 provides "[t]hat all deeds of gift, all conveyances, and all transfers or
4 assignments, verbal or written, of goods, chattels or things in action, made in trust for the use
5 of the person making the same, shall be void as against the existing or subsequent creditors
6 of such person."

7
8 At the time the petition was filed, the term of the Trust had not yet expired. Rose, as
9 Trustor, Trustee, and Term Holder, had the right to reside on and occupy the Property during
10 the Trust term. Important to this analysis is the fact that the gift of property to his son would
11 not be complete until the end of the ten year period. Prior to expiration, Rose not only had the
12 right to occupy the home, the Trust Agreement also granted him the power under
13 Paragraph 8(a) to "improve, sell, exchange, grant or exercise options to buy, any property at
14 any time held hereunder; to invest and reinvest in real property." According to Paragraph 3,
15 Rose was also entitled to payment of all trust income during the Trust term. Since a Qualified
16 Personal Residence Trust (QPRT) is treated as a grantor trust for income tax purposes, Rose
17 also had the right to deduct on his personal federal income tax return, interest paid on the
18 Property's mortgage under 26 U.S.C.A. § 163.

19
20 Also significant is the fact that although the Trust is classified as "irrevocable" in
21 Paragraph 9, Rose had the ability to terminate the Trust and distribute all proceeds to himself.
22 Paragraph 9(d) of the Trust provides that "[i]f the property is no longer used as the personal
23 residence, the Trust shall terminate and all assets shall be distributed to the Term Holder,
24 unless converted into a qualified annuity trust." Although Paragraph 3(b) provides that Rose
25 shall maintain the property as his personal residence, this requirement is subject to

1 Paragraph 9. As stated above, Paragraph 9 grants Rose the ability to terminate the Trust by
2 simply declaring that it will no longer be used as his personal residence.¹ Rose could also
3 terminate the Trust by selling the residence and electing to distribute the proceeds to himself
4 as Term Holder rather than investing in a replacement residence. Paragraph 9(c). It is this
5 ability to terminate the Trust and unfettered discretion to distribute the Property to himself that
6 brings the Trust within RCW 19.36.020, and similarly into Rose's bankruptcy estate under 11
7 U.S.C. § 541.

8
9 The Court is unaware of any cases in which a court has addressed the precise issue of
10 whether a QPRT created by a debtor, who is also the trustee, is property of the estate under
11 11 U.S.C. § 541.² There are, however, many bankruptcy court cases in which courts have
12 examined the issue of when trust assets are property of the estate in regards to trusts in
13 general. These cases support the Court's conclusion. See, e.g., In re Beatrice, 296 B.R. 576
14 (1st Cir. BAP 2003) (residential property that debtor transferred to trust for benefit of his
15 children was included in debtor's estate because he still exercised sufficient control over the
16 trust property); In re Herzig, 167 B.R. 707 (Bankr. D. Mass. 1994) (debtor's ability to terminate
17 a testamentary spendthrift trust was sufficient power over trust under New York law to bring it
18 into estate).

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22 ¹ The Court disagrees with the Chapter 7 Trustee that the Trust has already terminated because Rose has lived
23 in several locations during the Trust term. 26 C.F.R. § 25.2702-5 merely requires that the residence be
available, rather than actually used, as a personal residence. See 26 C.F.R. § 25.2702-5(c)(7). The Court does
not find the language in the Trust to be any more restrictive.

24 ² The unpublished decision cited by the Trust of In re Earle out of the Southern District of Alabama is
25 distinguishable in that the issue before the court in that case was a fraudulent conveyance claim. The Court
would note that the Earle case is also distinguishable in that the QPRT at issue in that case contained
restrictions on the trustees ability to transfer that are not present in this case. It is also noteworthy that in
examining whether the debtor retained possession or control of the property transferred, the court in Earle
determined that the scale tipped slightly in favor of the objecting creditor on this factor.

1 As a final matter, the Court deems it necessary to address the Trust's arguments
2 regarding the validity of the QPRT. A QPRT is an estate planning technique, that if properly
3 structured, can provide the trustor with significant tax benefits. The validity or invalidity of the
4 QPRT for tax purposes, however, is not relevant to the determination of whether the assets of
5 a QPRT are property of an estate in bankruptcy. In bankruptcy, a debtor's interest in property
6 is governed by state law and the bankruptcy code. Even if the existence of a valid QPRT
7 were determinative, the Court would note that it is questionable whether the Trust in this case
8 meets the necessary requirements. For instance, the governing instrument of a QPRT must
9 prohibit the trust from selling or transferring the residence, directly or indirectly, to the grantor
10 during the retained term interest of the trust. 26 C.F.R. § 25.2702-5(c)(9). The Trust contains
11 language that is directly at odds with this requirement. Pursuant to Paragraph 8(a) of the
12 Trust, the Trustee shall have the power to "sell any trust assets to and/or purchase assets
13 from, the Trustor, or any of them, and descendants of the Trustor, and/or estate of any such
14 person." (Emphasis added.)

16 As the Court determines that the Property is property of the estate under 11 U.S.C.
17 § 541, it is unnecessary to determine whether the transfer can be avoided as a fraudulent
18 conveyance.

19 The Court understands that this has been an emotional adversary proceeding for all
20 parties involved. In particular, Mary Rose, the former wife of Rose and mother of defendant
21 Alex Rose, has expressed her dissatisfaction with the manner and time it has taken to resolve
22 these issues. The Court would note that most of the delay was caused by Rose himself, who
23 essentially made no appearance in the main bankruptcy case until over two years after the
24 involuntary bankruptcy petition was filed. In the current adversary proceeding, Rose did not
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1 make an appearance until approximately ten months after the complaint was filed. Although
2 trial in this matter was continued on several occasions, this was done so at the parties request
3 and without objection. This was a difficult case, particularly because of the presence of a
4 minor defendant and pro se parties. The decision of the Court on this issue is based on
5 issues of law and not the credibility of the parties. The Court is required to follow the law, and
6 despite any alleged inequities, concludes that the Property is property of Rose's bankruptcy
7 estate subject to turnover by the Chapter 7 Trustee.
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9 DATED: November 8, 2005

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11 Paul B. Snyder
12 U.S. Bankruptcy Judge

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